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# GOVERNMENT OPERATION OF AMERICAN RAILROADS

BY CLIFFORD THORNE

The government operation, and possible ownership, of American railroads presents some issues of law and public policy that will be of commanding importance during the next few years. It will be well for every citizen to have a clear grasp of some of the fundamental facts about which this contest will be centered.

Government operation is a great experiment, and is fraught with many possible consequences of the first magnitude. Our object will be to outline briefly some of the essentials of the plan now pending in Congress, how that plan differs from the one adopted in Great Britain, and we will present a discussion of two or three of the principal objections which have been offered to the pending measure, with special reference to the compensation proposed in this greatest financial transaction in the history of the world.

Our object is not to produce an historical monograph for the antiquarian of the future to mull over, nor a dissertation on the many knotty constitutional and other legal problems involved. Both of these tasks would be interesting and instructive, perhaps. But there are a few vital issues of public policy involved in the legislation now pending which present real live questions worthy of the consideration of every citizen, and it is our purpose to discuss these issues. Unless we are gravely in error the railroad question will now be forced into national prominence, surpassing that which it has occupied for many years; and every man who has the responsibility of representing the people on this subject will be called upon at some future time to render a strict accounting for his acts of today.

To understand clearly the discussion and appreciate the relative importance of matters considered it is necessary to have a true conception of the object of taking over the railroads, and what it is expected to accomplish by that act.

At the moment of supreme test, when the public interest demanded the highest efficiency in our transportation system, private operation broke down and the government had to come to the rescue. Precisely the same thing occurred in Great Britain. This

did not happen in the other great civilized countries engaged in the present war, because they had already taken over the operation of most of their railroad systems many years ago. It is a noteworthy fact that not one of these other nations found it advisable to go back to private operation when the crisis came. The only nations which found it necessary to make a change in their methods of dealing with their railroads were those which substituted government operation for private operation.

The incidents leading up to this memorable event in the history of American railroads are interesting. For seven years our railway companies have maintained a national combination for the purpose of forcing general advances in freight rates. During this period several cases involving colossal sums of money have been won and lost. In the fall of 1917 the eastern and western railroads asked the Interstate Commerce Commission for a reopening of the celebrated Fifteen Per Cent Advance Rate Case. In the spring they had lost the case on approximately three-fourths of the traffic in the United States.<sup>1</sup> The sum involved in this one proceeding was stupendous, aggregating approximately four hundred million dollars annually, or 5 per cent on eight billion dollars, which is more money than the total cost of the Civil War. It is difficult for the human brain to comprehend such figures. The sum exceeds that involved in any other case between private parties in the history of civilization. During the course of the year 1917 our government floated a war loan of a little less than seven billion dollars, which has been described as the greatest in human history. Announcement has been made that during the coming year the government will need twenty billion dollars more money for war purposes.

At this critical moment the eastern railroads announced that if the advances they were then asking were granted in full the car-

<sup>1</sup> In 1911 the railroads lost their advanced rate cases completely. In the spring of 1914 they lost the 5 per cent case on approximately 90 per cent of the traffic involved. On rehearing in the fall of 1914 the Interstate Commerce Commission granted the eastern railroads the 5 per cent on approximately 50 per cent of the tonnage involved. In 1915 the western railroads lost their case on approximately 80 per cent of the tonnage involved. In the spring of 1917 the eastern roads were granted a 15 per cent advance on approximately two-thirds of the traffic involved, and the western and southern roads lost their case on approximately everything except coal, coke and iron. These figures are estimates only. Thousands of individual changes in rates have been made from time to time.

riers would come back immediately and request another 15 per cent. The western railroads had just applied for a reopening of their case. The unending cycle of advances, advances, advances, was appalling. The railroads over-played their hand. At this moment the shippers for the first time during all these proceedings from 1910 to 1917 took the position, as one of two or three alternatives, that the time had finally arrived for the government to take over the operation of American railroads. They urged the Commission to make this recommendation to Congress under the provision of the Act to Regulate Commerce requiring the Commission to make suggestions concerning important legislation affecting our transportation system. Within three weeks the Commission made a report to Congress naming government operation as one of the two alternatives which should be adopted by the government, and within six weeks the President took over the railroads.

Immediately after the suggestion of government operation was made by the shippers the proposition was bitterly fought by the railroads. Interviews against the measure were given out by leading railway executives. Newspapers and magazines with well recognized railroad sympathies, severely criticised the proposition.

When the government operation of railroads appeared inevitable the railroad officials reversed their attitude, and quickly established intimate relations with the government officials engaged in drafting the necessary legislative measures. The wisdom of this procedure was self-evident and it bore fruit in abundance, as we shall see.

#### ESSENTIALS OF THE PLAN NOW PENDING IN CONGRESS

Shortly after the reconvening of Congress in December, 1917, a bill was introduced in both Houses establishing the plan of government control. This measure contemplates the government operation of the principal railroad systems in the country under the immediate direction of one man. To fill this responsible post the President has selected the Honorable William G. McAdoo as Director General. Under the provisions of this bill the President is authorized to guarantee:

1. Regardless of how high the cost of labor and supplies may go during the war, the average net railway operating income for the three years ended, June 30, 1917, plus additional compensation for

all improvements built since that date out of new money, government loans, or earnings from operation.

2. To adequately maintain the properties.

3. To maintain railway credit by loaning all necessary funds for improvements and betterments.

4. To return the properties at the end of the period in as good condition as when taken.

If satisfactory agreements cannot be effected with any carriers the President has the option of increasing the compensation providing exceptional reasons exist, or the matter may be referred to a board of referees, and upon failure to agree the whole matter is subject to trial in the court of claims. Allowing for the inevitable increases for companies not accepting the proposed compensation, the total sum guaranteed will probably exceed one thousand million dollars annually. (The Senate Committee on Interstate Commerce estimates this at \$955,000,000 to \$960,000,000, if all roads should accept the original guarantee; but there are many short lines, whose earnings have been squeezed down by the large companies in the divisions of through rates. The large companies under the provisions of the bill will continue to get these excessive earnings, and the small roads will go into court, as provided in the bill, in order to secure additional compensation. A railroad system like the Pennsylvania will increase its standard return above the average of the three-year period in the following manner: the parent company will accept the guaranty provided in the bill and the subsidiary will go into court—and *that subsidiary may be owned completely by the parent company*. The settlement should be by "system." The original bill so provided it; but a clever change was made specifying a "railroad" or a system.)

The total bonded indebtedness of American railways, as of June 30, 1917, was \$10,021,730,075; and the capital stock outstanding in the hands of the public was \$6,314,570,354. After the payment of all interest the railroads as a whole, under the proposed guaranty will earn, net, approximately  $8\frac{1}{2}$  per cent on all their capital stock outstanding; this includes the rich and the poor, water and all. Think of substituting for the six billion dollars of railroad stocks in this country, six billion dollars worth of  $8\frac{1}{2}$  per cent government bonds. It is true the companies cannot increase their dividends during the period of federal control without the consent

of the President; but there is nothing to prevent the distribution of the accumulated surplus after the war is over. In the case of a bond the government takes your money and at the end of the period returns your money, paying interest in the interim. Likewise, under the plan of federal control, the government takes the property of the railway company guaranteeing to return the property at the end of the period, in as good a condition as when taken, and also guarantees an annual return. Here we have all the essentials of a government bond—the payment of the principal and interest.

We are shielding the railroads from the effects of the war; we are protecting them from all advances in the cost of materials and in the cost of labor; we are guaranteeing the railroads their net income earned during the most prosperous three-year period since the steam engine was invented—regardless of what may happen to their expenses.

During the years 1916 and 1917 American industry—including our railroads—received the profits from the very large demands occasioned by the European war, without being compelled to suffer the attendant losses that must inevitably follow our own active participation in the struggle. The result was that American industry in practically all lines reaped tremendous profits. That exceptional condition ceased when we entered the war. The earnings during such a period do not constitute a just criterion of normal earnings before or after that period.

Consider a few of the circumstances which make this true. When the war was thoroughly in progress large demands for clothing, food, and war munitions came from the European countries—demands far in excess of what they required in former years, because a large per cent of their population was not engaged in productive pursuits, and because of the enormous consumption of munitions which did not exist in former years. On the other hand, our industrial population was not depleted, and the ordinary traffic among our own people still continued. The excess demand from Europe was a net gain of vast proportions. All American business felt this tremendous stimulus.

In 1916 the net earnings of American railroads as a whole suddenly increased to an amount that was two hundred million dollars greater than ever before in their history. In 1916 the net income of the eastern railroads above all their expenses, taxes, and

interest on debt, exceeded any other year by more than sixty millions, an increase of over 27 per cent. These increases were very remarkable. Nothing like this had ever occurred before in the history of our country. The earnings of some companies had shown phenomenal increases at times, while others might remain stationary or decline; but an increase of this character in the whole industry was phenomenal. The fiscal year 1917 showed net earnings surpassing any other year, with the single exception of 1916. This condition in the railroad industry was simply analogous to what occurred generally throughout the nation.

But what will follow our own participation in the conflict—when we are on the same war footing as our allies?

First—one to five million active, strong men in the prime of their youth are to be taken from our farms and factories. The effect on the cost of labor and supplies is self-evident.

Second—it will be impossible for many industries to continue because ultimately we will have to concentrate our work, as never before, on the real necessities of life, in order to produce them in sufficient volume to meet the increased demands, with a decreased industrial population. The same thing has occurred in the leading European countries engaged in the war.

Third—capital will be extremely difficult to secure, and will command exorbitant rates. The war needs of the government will demoralize the money markets. Some conception of this may be gained when a person realizes just how much money the government will require to carry on this task of waging a war on another continent. The chief creditors of a government are, ordinarily, its own citizens. When their funds are drained, interest rates go skyward. A short time ago Anglo-French 5's, which have behind them the combined credit of England and France, were selling on a 9.3 per cent basis. City of Paris 6's have been selling on a 12.5 per cent basis. British consols—long considered the premier security of the world—have been selling at a yield ranging from 5 to 6 per cent. The  $5\frac{1}{2}$  per cent bonds of Great Britain which have but little risk connected with them, coming due next year, were selling during the closing weeks of 1917 on an 8.6 per cent basis. These government bonds in the past have been sold on a basis ranging from 2 to 4 per cent. When United States government bonds are sold on a 6 or 8 per cent basis, you will find industrials selling on a 10 or 12 per

cent basis, and the market values of industrial securities will decline accordingly.

During 1917 there was a slight recovery in money rates in Great Britain, due, undoubtedly, to our entrance into the war, and our furnishing much needed capital for some purposes. After the first effect of that has passed, and money for investment purposes in the United States becomes scarce, it is inevitable that the declines in security values will begin again on both continents. The extreme western portion of the United States has felt the pressure less than any other part of our country. Today money is being loaned for extended periods to private companies in California on a lower basis than the securities of the British government are being sold on the London market.

During the next few years it is certain that many individuals and companies will be unable to secure labor or materials except at enormous prices, and new capital will command very high rates. Coupled with this increased cost of operation the market for many products will be partially or wholly destroyed.

We, as a people, have not realized that which is inevitable if this war continues. The sooner we come to a realization of the true situation, the better it will be for all of us, and the more intelligently will we deal with the great problems pressing upon us for decision.

A document recently published for the purpose of encouraging investment in liberty bonds states that our government will require approximately twenty billion dollars annually for war purposes. The total income of the country has been estimated at about forty billion dollars. In other words, continues this publication, every citizen will be expected to contribute, on an average, one half of his entire income to the prosecution of the war, either in the payment of taxes or the purchase of bonds. Contemplate, for a moment, the effect of that on the many manufacturing concerns which are not directly connected with the war. Vast sums will be concentrated in this one line, which formerly went out into all the varied industrial activities of a great nation. Many industries will be demoralized, some will be destroyed, and thousands of business men will be forced to the wall.

## THE PROGRAM OF THE RAILWAY FINANCES

With a full appreciation of just what is in store for the average man let us now consider what the keen, able, far-sighted railroad financiers are trying at this moment to force through Congress, in the name of "patriotism," with just as little debate as possible, in advance of the treacherous times that are to come, and before the great body of our citizens, or their representatives, have paused to look forward into the future, before they have awakened to the real situation which confronts us as a nation. We do not claim that railroad officials have no patriotism. There is no class of men in America that are more patriotic. We simply denounce this constant attempt to increase the net revenues of railway companies under the subterfuge of patriotism. This is patriotic camouflage, nothing more nor less.

Some comprehension of just what the proposed guaranty means can best be obtained by considering a few concrete examples.

J. S. Bache and Company, of New York, have made an analysis of the proposed guaranty for a number of railroad systems. According to their computations, the New York Central will receive 12.4 per cent on its common stock.

During the past six years the stock of the New York Central has never commanded on the market a price as high as 120, and yet we propose to give the equivalent of a government bond, bearing a rate of over 12 per cent while the war lasts, to the New York Central stockholders.

The Bache Company estimates the return on the Pennsylvania stock to be 8.54 per cent; the Chicago and Northwestern 9.27 per cent; the Delaware, Lackawanna and Western 37.31 per cent; and the Reading 17.71 per cent.

The following table, compiled by the statistical department of the Interstate Commerce Commission, shows all of the companies in the United States earning 5 per cent or more on their capital stock. This table states what the various companies will earn on their stock under the three-year guaranty. (This appears in print for the first time in the Minority report of Senator Cummins.)

| Road                                    | Capital stock<br>actually outstand-<br>ing. Average for<br>the three years<br>ended June 30,<br>1917 (B) | Average net<br>income for the<br>three years<br>ended June 30,<br>1917 (C) | Average<br>per cent<br>of net in-<br>come to<br>capital<br>stock<br>(d)+(e)<br>(e) |
|---|--|--|--|
| (a)                                     | (c)  | (d)  | (e)  |
| EASTERN DISTRICT                        |  |  |  |
|   |  |  | <i>Per cent</i>  |
| Pennsylvania R. R. Co.....              | \$499,195,567  | \$44,534,939   | 8.92   |
| New York Central R. R. Co.....          | 249,676,128  | 32,367,269   | 12.96  |
| Balto. & Ohio R. R. Co.....             | 210,809,812  | 12,285,229   | 5.83   |
| Pennsylvania Co.....                    | 80,000,000   | 9,537,859  | 11.92  |
| Phila. & Reading Ry. Co.....            | 42,481,700   | 10,916,875   | 25.70  |
| Del., Lack. & Wn. R. R. Co.....         | 42,220,400   | 13,890,560   | 32.90  |
| Pgh., Cin. Chgo. & St. L. R. R. Co..... | 67,511,723   | 4,558,593  | 6.75   |
| Lehigh Valley R. R. Co.....             | 60,608,000   | 7,169,999  | 11.83  |
| Clev. Cin. Chic. & St. L. Ry. Co.....   | 57,027,200   | 5,048,902  | 8.85   |
| Michigan Central R. R. Co.....          | 18,736,400   | 3,463,464  | 18.48  |
| Central R. R. Co. of N. J.....          | 27,436,800   | 5,556,775  | 20.25  |
| Delaware & Hudson Co.....               | 42,502,600   | 5,437,547  | 12.79  |
| Phila. Balto. & Wash. R. R. Co.....     | 25,571,000   | 2,941,156  | 11.50  |
| Pitts. & Lake Erie R. R. Co.....        | 31,991,200   | 7,537,923  | 23.56  |
| Elgin, Joliet & En. Ry. Co.....         | 10,000,000   | 945,239  | 9.45   |
| Maine Central Ry. Co.....               | 18,199,317   | 1,605,075  | 8.82   |
| Buff. Roch. & Pgn. Ry. Co.....          | 16,500,000   | 1,560,021  | 9.45   |
| Bessemer & Lake Erie R. R. Co.....      | 500,000  | 3,236,080  | 647.22   |
| Chicago & Erie R. R. Co.....            | 100,000  | 70,449   | 70.45  |
| Hocking Valley R. Co.....               | 10,999,500   | 1,313,129  | 11.94  |
| West J. & Seashore R. R. Co.....        | 10,317,983   | 691,139  | 6.70   |
| Central New E. Ry. Co.....              | 8,547,200  | 717,566  | 8.40   |
| N. Y. Phila. & Nor. R. R. Co.....       | 2,500,000  | 893,508  | 35.74  |
| Rutland R. R. Co.....                   | 9,150,300  | 575,651  | 6.29   |
| Bangor & Aroostook R. R. Co.....        | 4,079,067  | 337,808  | 8.28   |
| Cumberland Val. R. R. Co.....           | 5,333,550  | 1,280,684  | 24.01  |
| Kanawha & Michigan Ry. Co.....          | 9,000,000  | 991,665  | 11.02  |
| Lehigh & N. E. R. R. Co.....            | 6,000,000  | 819,722  | 13.66  |
| Chgo. Terre H. & S. En. Ry. Co.....     | 4,300,000  | 234,761  | 5.46   |
| Lehigh & Hudson River Ry. Co.....       | 1,340,000  | 374,915  | 27.98  |
| Monongahela Ry. Co.....                 | 3,809,333  | 352,809  | 9.26   |
| Cincinnati Nn. R. R. Co.....            | 3,000,000  | 268,573  | 8.95   |
| Port Reading R. R. Co.....              | 2,000,000  | 182,547  | 9.13   |
| Det. & Toledo S. L. R. R. Co.....       | 1,428,000  | 348,020  | 24.37  |
| Buf. & Sus. R. R. Corp.....             | 7,000,000  | 496,203  | 7.09   |
| Staten Is. R. T. Co.....                | 500,000  | 160,119  | 32.02  |
| Detroit & Mack. Ry. Co.....             | 2,950,000  | 218,976  | 7.42   |
| Total.....                              | \$1,593,322,780  | \$182,921,748  | 11.48  |

| Road<br><br>(a)  | Capital stock<br>actually outstand-<br>ing. Average for<br>the three years<br>ended June 30,<br>1917 (B)<br>(c) | Average net<br>income for the<br>three years<br>ended June 30,<br>1917 (C)<br>(d) | Average<br>per cent of<br>net income<br>to capital<br>stock<br>(d) + (e) |
|--|---|---|--|
| <b>SOUTHERN DISTRICT</b>                               |   |   |  |
| Illinois Central R. R. Co.....                         | \$109,288,114   | \$12,383,882  | <i>Per cent</i><br>11.33   |
| Louisville & Nashville R. R. Co.....                   | 72,000,000  | 12,056,800  | 16.75  |
| Norfolk & Western Ry. Co.....                          | 138,580,867   | 17,342,810  | 12.51  |
| Chesapeake & Ohio Lines.....                           | 62,786,000  | 5,848,431   | 9.31   |
| Atlantic Coast Line R. R. Co.....                      | 68,754,700  | 7,424,004   | 10.80  |
| Central of Georgia Ry. Co.....                         | 20,000,000  | 1,878,570   | 9.39   |
| Nashville, Chattanooga & St. Louis Ry. ....            | 15,994,831  | 2,175,426   | 13.60  |
| Mobile & Ohio R. R. Co.....                            | 6,016,800   | 888,067   | 14.76  |
| Cincinnati, New Orleans & Texas Pacific Ry.<br>Co..... | 5,443,400   | 2,448,928   | 44.99  |
| Florida East Coast Ry. Co.....                         | 10,833,333  | 1,090,321   | 10.06  |
| Alabama Great Southern Ry. Co.....                     | 11,210,350  | 1,364,246   | 12.17  |
| New Orleans & North Eastern R. R. Co....               | 6,000,000   | 646,449   | 10.77  |
| Richmond, Fredericksburg & Potomac R. R.<br>Co.....    | 4,315,067   | 979,486   | 22.70  |
| Georgia Southern & Florida Ry. Co.....                 | 3,768,000   | 222,186   | 5.90   |
| Charleston & Western Carolina Ry. Co. ....             | 1,200,000   | 230,036   | 21.67  |
| Gulf & Ship Island R. R. Co.....                       | 7,000,000   | 373,070   | 5.33   |
| Alabama & Vicksburg R. R. Co.....                      | 2,100,000   | 360,784   | 17.18  |
| Washington & Southern Ry. Co.....                      | 4,000,000   | 348,641   | 8.72   |
| Atlanta & West Point R. R. Co.....                     | 2,463,600   | 292,922   | 11.89  |
| Western Railway of Alabama.....                        | 3,000,000   | 251,851   | 8.39   |
| Total.....   | \$554,745,062   | \$68,636,910  | 12.37  |

| Road<br>(a)   | Capital stock<br>actually outstand-<br>ing. Average for<br>the three years<br>ended June 30,<br>1917 (B)<br>(c) | Average net<br>income for the<br>three years<br>ended June 30,<br>1917 (C)<br>(d) | Average<br>per cent of<br>net income<br>to capital<br>stock<br>(d) ÷ (e)<br>(e) |
|---|---|---|---|
| <b>WESTERN DISTRICT</b>                               |   |   |   |
| Atchison, Topeka & Santa Fe Ry. Co.....               | \$332,323,877   | \$32,230,021  | Per cent<br>9.70  |
| Southern Pacific Co.....                              | 276,725,239   | 17,933,726  | 6.60  |
| Chicago, Milwaukee & St. Paul Ry. Co. ....            | 233,335,167   | 14,336,613  | 6.15  |
| Chicago, Burlington & Quincy R. R. Co..... (G)        | 110,839,100   | 24,444,045 (G)  | 22.05   |
| Chicago & Northwestern Ry. Co.....                    | 157,591,852   | 16,040,515  | 10.18   |
| Great Northern Ry. Co.....                            | 249,361,866   | 24,021,887  | 9.63  |
| Northern Pacific Ry. Co.....                          | 347,283,000   | 24,287,781  | 9.87  |
| Union Pacific R. R. Co.....                           | 321,836,100   | 31,018,338  | 9.34  |
| Minneapolis, St. Paul & Ste Marie Ry..... (G)         | 37,810,200  | 4,571,790 (G)   | 12.09   |
| Oregon Short Line R. R. Co.....                       | 100,000,000   | 9,381,016   | 9.38  |
| Texas & Pacific Ry. Co. (Rec.).....                   | 32,755,110  | 2,548,330   | 6.58  |
| Chicago, St. Paul, Minneapolis & Omaha Ry.<br>Co..... | 29,815,000  | 3,854,452   | 9.57  |
| Duluth, Missabe & Northern Ry. Co. ....               | 4,112,500   | 4,693,088   | 114.12  |
| El Paso Southwestern Co..... (G)                      | 25,000,000  | 2,190,198 (G)   | 8.78  |
| Houston & Texas Central R. R. Co.....                 | 10,000,000  | 1,089,368   | 10.88   |
| Duluth & Iron Range R. R. Co.....                     | 5,333,333   | 3,040,987   | 38.27   |
| Fort Worth & Denver City Ry. Co.....                  | 9,243,800   | 1,297,029   | 14.03   |
| Panhandle & Santa Fe Ry. Co.....                      | 804,500   | 389,097   | 64.37   |
| St. Louis, Brownsville & Mexico Ry. Co....            | 500,000   | 263,544   | 52.71   |
| Chicago, Rock Island & Gulf Ry. Co. .... (G)          | 469,000   | 83,685 (G)  | 17.84   |
| Bingham & Garfield Ry. Co.....                        | 6,171,667   | 1,405,681   | 22.78   |
| Louisiana Western Ry. Co.....                         | 3,360,000   | 802,684   | 23.89   |
| Nevada Northern Ry. Co.....                           | 2,000,000   | 879,907   | 43.99   |
| Vicksburg, Shreveport & Pacific Ry. Co....            | 4,999,300   | 299,634   | 5.99  |
| Houston East & West Texas Ry. Co.....                 | 1,920,000   | 234,199   | 12.20   |
| Cripple Creek & Colorado Springs Ry. Co. .            | 757,000   | 171,619   | 22.67   |
| Colorado & Wyoming Ry. Co.....                        | 100,000   | 162,636   | 162.64  |
| Wichita Valley Ry. Co.....                            | 1,020,000   | 117,936   | 11.56   |
| Arizona & New Mexico Ry. Co.....                      | 3,770,000   | 337,314   | 8.58  |
| Total.....  | \$2,210,635,811   | \$220,076,073   | 9.96  |

An important objection has been made to statements concerning the guaranteed net income on capital stock. Net income under the Commission's system of accounting includes not only earnings from operation but income from outside investments. The government does not guarantee these outside revenues. Another objection which can be made to the computations quoted above is that they fail to show system figures. A parent company may have several subsidiaries that do not earn much on their outstanding capital stock.

In order to meet both of these objections and to ascertain the real effect that such modifications would have on the results, we have compiled the statistics for the railroad systems handling 72 per cent of the traffic in the eastern district. In column A we show the average dividend rate on the system; in column D the average return, including income from outside sources as well as revenues from operation during the past three years; in column F we have eliminated all income from outside operations. These railroad systems under the government guaranty will be able to pay all of their operating expenses, taxes, interest on funded and unfunded debt, rentals, leases, etc., and have enough left out of earnings from operation alone, to equal an average of 10 per cent on all their capital stock outstanding in the hands of the public. In addition to this government bond for 10 per cent during the war, these companies will have large revenues from outside sources. During the past three years, this outside income has averaged over \$30,000,000 a year. This table has been compiled from the exhibit prepared by the eastern railroads in the Fifteen Per Cent Case before the Interstate Commerce Commission. (See table on p. 96.)

In contrast with the foregoing statements showing the situation on American railroads, under the proposed government guaranty, we present a somewhat similar table (p. 97) showing the government guarantees on the roads handling 86.60 per cent of the traffic in Great Britain. These earnings should be further reduced by reason of the modification caused by the increased wages, a portion of which the railroad companies have assumed.

Summarizing the situation, it may be stated that the railroad bill now pending before Congress proposes the following guarantees made on behalf of the government of the United States: (1) to return the properties at the end of the period of government control in as good condition as that at the time they were taken over; (2) to loan the railroads all the money necessary for betterments and improvements, probably at the rate on government bonds; (3) to shield the large prosperous railroad systems from all future increases in the cost of labor and supplies while the war lasts; (4) to protect these larger railroads from all financial hazards of the war which will threaten the very life of many industries, and possibly wreck many railroads that will not be granted a government guaranty; (5) and to guarantee the larger railroads, annually,

## STATEMENT OF THE NET INCOME AND CAPITAL STOCK, EASTERN RAILROADS, YEAR ENDING JUNE 30, 1917

| Name of road                         | 1917 dividend rate (system avg.), (%) | Capital stock outstanding in 1917 | Average net income three years 1915-1917 | Average return on 1917 capital stock (%) | Average net income less other income 1915-1916-1917 | Average guaranteed return (%) |
|--------------------------------------|---------------------------------------|-----------------------------------|--|--|---|-------------------------------|
|                                      | A                                     | B                                 | C  | D  | E   | F                             |
| Bessemer & Lake Erie R. R.           | 11.36                                 | \$12,498,850                      | \$3,515,494                              | 28.12                                    | \$3,453,631   | 27.63                         |
| Central R. of New Jersey             | 11.68                                 | 28,716,800                        | 5,597,651                                | 19.49                                    | 4,634,079   | 16.14                         |
| Delaware & Hudson Co.                | 8.82                                  | 56,855,500                        | 6,469,916                                | 11.38                                    | 4,428,769   | 7.79                          |
| Delaware, Lackawanna & Western R. R. | 12.83                                 | 87,048,638                        | 16,545,849                               | 19.01                                    | 11,824,622  | 13.58                         |
| Lehigh Valley R. R.                  | 9.76                                  | 62,110,998                        | 7,026,317                                | 11.31                                    | 3,846,914   | 6.19                          |
| New York Central System.             | 5.50                                  | 369,230,457                       | 49,425,960                               | 13.39                                    | 39,371,056  | 10.66                         |
| Norfolk & Western Ry.                | 7.16                                  | 143,397,200                       | 17,341,467                               | 12.09                                    | 16,520,923  | 11.52                         |
| Pennsylvania R. R. System.           | 6.48                                  | 620,588,186                       | 66,418,510                               | 10.70                                    | 54,379,661  | 8.76                          |
| Reading System.                      | 7.10                                  | 98,558,337                        | 11,466,252                               | 11.63                                    | 11,240,132  | 11.40                         |
| Chesapeake & Ohio Ry.                | 4.00                                  | 62,786,000                        | 5,844,756                                | 9.31                                     | 4,859,525   | 7.74                          |
| Buffalo Rochester & Pittsburgh R. R. | 6.00                                  | 16,500,000                        | 1,560,021                                | 9.45                                     | 1,478,723   | 8.96                          |
| Lehigh & New England R. R.           | 8.00                                  | 6,000,000                         | 819,477                                  | 13.66                                    | 784,957   | 13.08                         |
| Hocking Valley Ry.                   | 4.00                                  | 10,999,500                        | 1,313,128                                | 11.94                                    | 1,279,985   | 11.64                         |
| Lehigh & Hudson River Ry.            | 12.00                                 | 1,340,000                         | 374,413                                  | 27.94                                    | 369,252   | 27.56                         |
| Total                                | 6.94                                  | \$1,576,630,466                   | \$193,719,211                            | 12.29                                    | \$158,472,228                                       | 11.05                         |

NOTE: The foregoing table has been compiled from the exhibits offered by the railway companies in the Fifteen Per Cent Case, last November—the case being tried before the Interstate Commerce Commission.

We show the rate of return which was earned by fourteen of the principal railroad systems in the Eastern District. These roads handled 72 per cent of the traffic in said District last year. Net income includes income from operation as well as that which is received from outside investments, known as "other income." First, we show the ratio this factor, known as net income, bears to the capital stock outstanding. Second, we have subtracted from the net income, all income from outside sources. This leaves only the earnings derived from operation of the railroad property after all interest charges are paid. We then show the rate that this net income from operation bears to the capital stock.

<sup>1</sup> This percentage differs slightly from that given before the Congressional Committees recently, as the percentage here is based on the 1917 capital stock (being brought down to the latest year) instead of on the average capital stock for the three years.

## RAILWAYS IN UNITED KINGDOM WHOSE GROSS RECEIPTS FOR YEAR 1913 EXCEEDED £1,000,000

| Name of road  | Gross receipts<br>£ | Ordinary stock | Preferential stock | Guaranteed stock | Total stock<br>(a) | Dividends on ordinary stock<br>£ | Dividends on preferential and guaranteed stock<br>£ | Total dividends<br>£ | Rate of dividend (%) | Net income<br>£ | Fixed charges <sup>1</sup><br>£ | Net income less fixed charges<br>£ | Rate of return (%)<br>(b) |
|---|---------------------|----------------|--------------------|------------------|--------------------|----------------------------------|---|----------------------|----------------------|-----------------|---------------------------------|------------------------------------|---------------------------|
| Great Central.....  | 5,929,558           | 10,658,020     | 17,185,428         | 3,382,061        | 31,225,509         | .....                            | 866,076   | 866,076              | 2.77                 | 2,218,221       | 1,352,885                       | 865,336                            | 2.77                      |
| Great Eastern.....  | 6,015,142           | 15,362,886     | 14,731,708         | 6,094,627        | 36,189,221         | .....                            | 825,228   | 1,209,300            | 3.34                 | 2,173,330       | 950,355                         | 1,222,945                          | 3.38                      |
| Great Northern.....   | 6,742,119           | 22,454,250     | 19,755,520         | 3,435,740        | 45,649,520         | .....                            | 910,910   | 1,699,748            | 3.72                 | 2,463,016       | 700,189                         | 1,762,827                          | 3.86                      |
| Great Western.....  | 15,431,412          | 36,695,210     | 11,936,348         | 25,555,191       | 74,186,749         | .....                            | 1,874,577   | 4,159,023            | 5.61                 | 5,929,034       | 1,574,657                       | 4,354,377                          | 5.87                      |
| Lancashire and Yorkshire.....                                     | 6,595,159           | 18,821,470     | 29,104,816         | 2,596,012        | 50,522,298         | .....                            | 846,966   | 1,019,267            | 3.69                 | 2,602,111       | 713,811                         | 1,888,300                          | 3.74                      |
| London and North Western.....                                     | 16,326,621          | 42,890,095     | 27,875,631         | 15,100,402       | 85,864,132         | .....                            | 3,002,306   | 4,721,268            | 5.50                 | 6,334,585       | 1,512,792                       | 4,821,803                          | 5.62                      |
| London and South Western.....                                     | 5,414,019           | 22,189,814     | 18,700,226         | 797,980          | 41,688,020         | .....                            | 738,526   | 1,589,725            | 3.81                 | 2,190,502       | 585,021                         | 1,595,481                          | 3.83                      |
| London, Brighton & South Coast.....                               | 3,534,118           | 10,447,085     | 10,121,672         | 1,955,860        | 22,524,617         | .....                            | 548,472   | 603,876              | 5.12                 | 1,534,911       | 378,445                         | 1,156,466                          | 5.13                      |
| Midland.....  | 15,129,135          | 78,195,397     | 63,985,974         | 18,089,560       | 160,273,931        | .....                            | 2,636,194   | 4,706,145            | 2.94                 | 6,362,738       | 1,434,787                       | 4,927,951                          | 3.07                      |
| North Eastern.....  | 11,315,130          | 32,036,605     | 16,273,797         | 8,503,295        | 56,813,697         | .....                            | 991,046   | 3,233,188            | 5.69                 | 4,454,968       | 914,869                         | 3,540,099                          | 6.23                      |
| North Staffordshire.....  | 1,058,978           | 3,594,650      | 3,317,483          | 1,170,000        | 8,082,133          | .....                            | 179,732   | 337,756              | 4.18                 | 441,288         | 95,071                          | 346,217                            | 4.28                      |
| Southeastern and Chatham Railway                                  | .....               | .....          | .....              | .....            | .....              | .....                            | .....   | .....                | .....                | .....           | .....                           | .....                              | .....                     |
| Compulsory Managing Committee:                                    | 4,890,589           | .....          | .....              | .....            | .....              | .....                            | .....   | .....                | .....                | .....           | .....                           | .....                              | .....                     |
| London, Chatham and Dover.....                                    | 11,259,282          | 10,049,230     | 12,286,385         | 1,784,300        | 24,119,915         | .....                            | 331,107   | 935,909              | 3.88                 | 1,416,960       | 483,537                         | 933,423                            | 3.87                      |
| South Eastern.....  | .....               | .....          | .....              | .....            | .....              | .....                            | .....   | .....                | .....                | .....           | .....                           | .....                              | .....                     |
| Total England and Wales.....                                      | 98,381,981          | 314,653,994    | 253,158,820        | 88,587,345       | 656,400,159        | 14,166,341                       | 12,641,490  | 26,807,831           | 4.08                 | 38,937,867      | 11,189,702                      | 27,748,165                         | 4.23                      |
| Caledonian.....   | .....               | .....          | .....              | .....            | .....              | .....                            | .....   | .....                | .....                | .....           | .....                           | .....                              | .....                     |
| Glasgow and South Western.....                                    | 5,129,155           | 35,569,256     | 14,528,437         | 9,268,154        | 59,363,847         | 646,311                          | 968,183   | 1,614,494            | 2.72                 | 2,334,041       | 707,851                         | 1,626,190                          | 2.74                      |
| North British.....  | 2,012,737           | 12,654,790     | 5,491,091          | 2,260,450        | 20,406,331         | 314,052                          | 301,962   | 616,014              | 3.02                 | 825,568         | 229,969                         | 595,599                            | 2.92                      |
| Great Northern of Ireland.....                                    | 5,254,607           | 21,579,157     | 27,575,987         | .....            | 49,155,144         | 437,361                          | 1,078,530   | 1,516,191            | 3.08                 | 2,427,282       | 857,725                         | 1,569,557                          | 3.19                      |
| Great Southern and Western.....                                   | 1,191,286           | 4,049,989      | 1,749,005          | 869,270          | 6,668,264          | 224,997                          | 104,730   | 337,727              | 5.21                 | 457,631         | 105,788                         | 351,843                            | 5.28                      |
| .....   | 1,630,766           | 5,479,800      | 1,696,765          | 2,896,184        | 10,072,749         | 266,276                          | 184,196   | 450,472              | 4.47                 | 716,018         | 215,362                         | 500,656                            | 4.96                      |
| Total United Kingdom.....   | 113,600,532         | 393,986,986    | 304,198,105        | 103,881,403      | 802,066,494        | 16,073,338                       | 15,279,391  | 31,352,729           | 3.91                 | 45,698,407      | 13,306,397                      | 32,392,010                         | 4.04                      |
| Per cent of gross receipts of all railways in United Kingdom..... | 86.60               | .....          | .....              | .....            | .....              | .....                            | .....   | .....                | .....                | .....           | .....                           | .....                              | .....                     |

<sup>1</sup> Includes interest on loans, debenture stock and miscellaneous fixed charges.<sup>2</sup> Gross receipts of all railways as follows: England and Wales, £109,908,244; Scotland, £13,642,742; Ireland, £4,623,167; Total, £128,174,163. Authority, Railway Returns of the United Kingdom for the Year, 1913.

sums that will be sufficient to pay all their operating expenses, taxes, interest, dividends and surplus equal to that which they have earned during the years 1915 to 1917 inclusive, the most prosperous three-year period in their entire history.

It is also proposed, as stated by the author of the major portion of the bill, that the shippers, who will have their own burdens to carry during this perilous time, will be expected to make up any deficit of the government in the guaranty made to the railroads.

We can snuff out the life of our boys in the trenches. We can wreck many industries. We can blast the business of the short line, the poor road. But when it comes to these rich, powerful corporations, the big companies, the great railroads, we heroically announce that we are going to protect them from the effects of the war. And we do all this in the name of patriotism.

To the Burlington Railroad we say, "You now have a stock paying a regular dividend of 8 per cent. While the war lasts please accept this 22 per cent government bond in lieu of that railroad stock. We not only guarantee you this 22 per cent annually on your stock; but we guarantee to return the principal in full in this manner—after the war is over we solemnly guarantee to give back your property in just as good a condition as we take it." This has all the essential elements of a 22 per cent government bond. While the war lasts the government guarantees the annual payment on the stock, and at the end of the war the government guarantees to return the property in full. Here you have the payment of the principal and the interest. Not only do we guarantee to the Burlington annually that 22 per cent on its capital stock, but we also guarantee, with all the wealth and resources of the United States government back of the pledge, that we shall pay all interest charges on all its funded and unfunded debt, maintain its properties adequately and efficiently, and present to the Burlington Railroad an absolute government credit, enabling the company to borrow all the money it may need. We tell the Burlington Railroad to go ahead, rehabilitate and improve its property out of the public treasury, while many other industries are being prostrated; and then don't forget to take that little check annually for 22 per cent. We do all this in the name of patriotism.

It has been suggested that the payment of these large earnings to the railroads is necessary to facilitate the sale of government

bonds. How will it help the sale of 4 or  $4\frac{1}{2}$  per cent government bonds to give a government guaranty to railroad stocks amounting to 10 per cent annually? It is axiomatic that the higher you make the prevailing rate on other securities, the more difficult will it be to sell government bonds at a lower rate. Where is there any reason for thinking a guaranty of 10 per cent instead of 6 or 7 per cent on railroad stocks will facilitate the sale of government bonds? Why should the stockholder part with the 10 per cent security in order to purchase a  $4\frac{1}{2}$  per cent government bond? The higher you make the earnings on railroad securities, the more difficult will it be to persuade the railroad stockholder to part with his security. The logic involved in advocating a 10 per cent or 20 per cent return on railroad stock in order to help the sale of 4 or 5 per cent government bonds is a charming exhibition of the usual statesmanlike stupidity which governs our public activities.

Our first task is to win the great war, but that cannot be used to throw dust in our eyes on matters of justice as between the citizens of this country. There are some offenses that cannot be committed with impunity, even though they be done in the name of patriotism. We are patriots first, last, and all the time; but we are not fools. There is such a thing as camouflage in the demagogic panegyrics of the politician who does everything, big and little, right or wrong, in the name of patriotism.

#### TERMINATION OF GOVERNMENT CONTROL

The measure originally presented provided no definite time for the termination of the government operation of our railroads. The Senate Committee amended this, limiting the time to eighteen months after the termination of the war. The House Committee has amended the bill, limiting the time of operation to a period of two years after the war. The possible effect of no limit on the period of government operation has precipitated vigorous discussion from both the friends and opponents of government ownership. Various and conflicting claims have been made. Whatever policy is subsequently adopted, it is quite essential that a substantial period shall elapse during which necessary legislation can be enacted to meet the situation then existing and providing for the necessary accounting. There is no doubt but what Congress will limit the period of government operation. As the time limit approaches, the

entire subject of government ownership versus private ownership will be forced into prominence.

#### JURISDICTION OF THE INTERSTATE COMMERCE COMMISSION

Practically everyone recognizes the necessity for concentrating the operation of American railroads in the hands of the President during the emergency now confronting the nation. Another question, however, has arisen. This relates to the jurisdiction of the Interstate Commerce Commission over rates and charges of the railway companies. At the present writing, the committees in the two houses of Congress are divided on this proposition; the Senate Committee recommended a bill giving power of initiating rates into the hands of the President, and leaving the jurisdiction with the Commission to finally determine the reasonableness of any and all changes under the Act to Regulate Commerce and the amendments thereto. The House Committee has declined to accept this amendment to the bill as originally proposed. This is but a passing phase of a contest that has been carried on for many years to cripple, and if possible, to destroy the Commission. The shipper like the railroad will suffer from the inconveniences and hardships occasioned by government operation interfering with the ordinary movements of traffic, and giving priority to those commodities most essential to the efficient prosecution of the war. It can safely be said that both the railroad and the shipper have patriotically consented to this interference, without objection.

However, on matters of compensation a different situation exists. There is no necessary connection between the efficient operation of the railroad and the determination of the proper compensation to be paid by the government to the railway company. There may be some relation between the two, but it is incidental, and not of substantial importance. The railway company has a right to a full hearing before a disinterested tribunal if an agreement cannot be effected between the government and the company, and no one has even suggested that this right should be interfered with by the so-called "war power." The shipper claims that his rights to a full hearing relative to the compensation to be paid by the shipper are just as sacred as are those involving the compensation to be paid to the railroad. The justice of the demand on behalf of the shipper to a full hearing has been forcibly stated by the Supreme Court in

*Interstate Commerce Commission v. Louisville, etc.* (227 U. S. 88), wherein the following language appears:

But such a construction would nullify the right to a hearing,—for manifestly there is no hearing when the party does not know what evidence is offered or considered and is not given an opportunity to test, explain, or refute. The information gathered under the provisions of section 12 may be used as basis for instituting prosecutions for violations of the law, and for many other purposes, but is not available, as such, in cases where the party is entitled to a hearing. The Commission is an administrative body and, even where it acts in a quasi-judicial capacity, is not limited by the strict rules, as to the admissibility of evidence, which prevail in suits between private parts. *Interstate Commerce Commission v. Baird*, 194 U. S. 25. But the more liberal the practice in admitting testimony, the more imperative the obligation to preserve the essential rules of evidence by which rights are asserted or defended. In such cases the Commissioners cannot act upon their own information as could jurors in primitive days. All parties must be fully apprised of the evidence submitted or to be considered, and must be given opportunity to cross-examine witnesses, to inspect documents and to offer evidence in explanation or rebuttal. In no other way can a party maintain its rights or make its defense. In no other way can it test the sufficiency of the facts to support the finding. *Interstate Commerce Commission v. Louisville & Nashville Railroad*, 227 U. S. 88, 93.

We have had the Interstate Commerce Commission for thirty years. During this period our railroads have prospered. The best evidence of this fact is that the companies handling the bulk of the traffic in the nation have been able to pay liberal dividends, and the net revenues of the American railroads as a whole during the past three years have exceeded the net revenues of any other like period. This fact has been conclusively established beyond controversy. During the next few years the Commission will be of greater importance to the shipper than during any other like period in our history.

#### ADVANCED FREIGHT RATES

There are some who are advocating a general advance in freight rates in the United States, should it become necessary to make up any deficit in the amount guaranteed to American railroads under the provisions of the bill now pending. Before the government should adopt such a policy there are some facts worthy of serious consideration. At the outset it must be remembered that such a course of action would be diametrically opposed to that which has been adopted in Great Britain.

The expedited special service required by the government in the movement of troops, munitions and other war supplies will serve to discommode other traffic, creating embargoes, confusion, extended delays, forcing other trains, both passenger and freight, to give way to the movement of trains carrying war supplies. No one is objecting to these inevitable hardships, but attention is called to the fact that the government is thereby securing expedited special services for ordinary rates. It would be very difficult to estimate the actual cost of this kind of service and the attendant confusion occasioned to other traffic. This extra service is in all respects a governmental activity and the burden should be borne by the government,—by the public generally—not by the shipper. If every shipper were able to pass on the cost to the consumer it might not work any hardship to advance the freight rates to take care of these extra costs; but in actual practice we find that some jobbers and some manufacturers in certain lines of industry in the cities, are able to pass on the burden to the consumer; but, on the other hand, many jobbers, manufacturers and producers have to absorb the larger portion of any advance in freight rates that is made. This is true of the oil industry because the chief competitor of the independent is enabled to ship his product largely through pipe lines. The price on grain is generally the price at the market less the transportation charge from point of origin. The same is true of the livestock traffic. Even where the shipper is able to pass on the burden to the consumer there are certain objections. A tax (and this has all the essential elements of a tax) pro-rated in that manner compels the man who buys the necessities of life to bear the heavy part of the load and it is not apportioned in accordance with the ability to pay the tax. Many times the manufacturer or jobber uses such an increase as an excuse for levying an additional charge upon the public for the common necessities of life amounting to several times the actual increased cost.

We should keep clearly in mind the distinction between the ratepayer and the taxpayer. The shipper is perfectly willing and is glad to bear his fair share of the burden of the cost of this war. He could rightfully object, however, to any program which forces him to bear his share and, in addition thereto, to carry other people's burdens. These extraordinary costs of operation occasioned by confusion, congestion, etc., are caused by the government; they

are a part of the war program. This extra cost should be borne by the taxpayer and not by the ratepayer. Of course the shipper will then bear his fair share of the burden.

The shipper will have to bear his own increases in the cost of labor and supplies along with the rest of the people. It would seem unfair to compel him also to bear the increased cost of labor and supplies of the railroad companies occasioned by the war. The reason we say to the railroads that we will protect them from these increased expenses is because we consider our transportation system an essential governmental agency at this crucial time. We do it as a matter of public policy. It is a burden assumed by the government and the citizens as a whole should share in that burden, instead of forcing it upon a relatively small group of shippers scattered throughout the country. As previously stated what we suggest is precisely the policy that has been adopted in Great Britain. It is sound economically, morally, and legally.

#### GOVERNMENT OPERATION IN GREAT BRITAIN

The essentials of the British plan for the operation of railroads during the war may be briefly described as follows:

1. A committee of thirteen, including the president of the Board of Trade and the general managers of the leading British railroads are in active control of the railways in England, Wales and Scotland, under authority of the Act of 1871.

2. The government undertakes to maintain the properties on a standard similar to that existing prior to the war, except that a certain percentage, said to be  $12\frac{1}{2}$  per cent, is added to the maintenance allowances of the pre-war period, because of the extra cost and wear and tear occasioned by high prices and the extraordinary use now demanded of the railroads.

3. The government guarantees the net income for the year 1913 less an amount equal to one-fourth of the first wage bonus granted to labor, the total reduction amounting to approximately £1,000,000. (The original reduction was equal to the amount by which their net revenues during the first seven months of 1914 fell below the corresponding period of 1913. This condition or proviso was stricken out and the reduction named above was substituted therefor.)

4. No payment is made for the movement of government troops or munitions, it being presumed that the payment of the

difference between the guaranty and the receipts from other traffic is sufficient compensation for this service.

5. Very large and substantial increases in wages have been paid to labor. The first advance was divided as follows: the government assumed three-fourths of the amount and the railway companies assumed the other one-fourth by reducing their guaranteed return to that extent, as described above. All subsequent advances in wages have been assumed by the government. There has been no general advance in freight rates during the war. In 1913 there was an increase of approximately 4 per cent, which it is said became operative at a somewhat later date. This was about the time the 5 per cent was granted by the Interstate Commerce Commission on 50 per cent of the traffic in the eastern district.

There are certain essential differences in the method adopted in Great Britain and that contemplated in the United States in connection with the taking over of the railroads.

In Great Britain the dividends average much less than the dividends on railway stocks in this country. In Great Britain the average surplus (as well as the *typical* surplus) is approximately one-half of 1 per cent. In the United States the average surplus above dividends for the year ending June 30, 1917, was approximately 4 per cent. In other words, the surplus in the United States is approximately eight times as great as the surplus in Great Britain. The guaranty of the net income for 1913 in Great Britain with the subsequent modification that was adopted was not even sufficient to insure the payment of dividends on the principal railroads of the country. We here present an extract from a statement compiled by the Legislative Reference Department of the Congressional Library, the document being prepared by Mr. Gilbert Hirsch.

Before the terms were made public, a report had got out that the basis of compensation was to be a government guarantee of the existing dividend. The Investors' Review had it that the dividend average for the three preceding years was to be the basis of this guarantee.<sup>2</sup>

Even after the terms became known, it was popularly assumed that they involved a guarantee that the government would give the railway shareholders every existing dividend.<sup>3</sup> The Railway News stated, shortly after the announce-

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<sup>2</sup> September 19, 1914, p. 319.

<sup>3</sup> Mr. Healy in the House of Commons, May 3, 1917, 93 H. C. Deb., pp. 564-565.

ment<sup>4</sup> that shareholders would get dividends at rates approximately equal to those of 1913. And the Economist declared, over a year later<sup>5</sup> that dividends are more or less guaranteed under the arrangement with the government. There has, however, been some falling off in the dividend rate during the war.<sup>6</sup>

The following statistics have been prepared by James H. Oliphant & Co., of New York, and show the situation on nine of the leading railroads in Great Britain.

#### WAR-TIME DIVIDENDS OF BRITISH RAILWAYS

[There follows a selected list of the common or ordinary stocks of several of the most important British railways, together with their dividend records, 1913 to 1916, inclusive.]

|                             | 1913            | 1914            | 1915            | 1916            |
|-----------------------------|-----------------|-----------------|-----------------|-----------------|
|                             | <i>Per cent</i> | <i>Per cent</i> | <i>Per cent</i> | <i>Per cent</i> |
| Caledonian.....             | 3½              | 3½              | 3½              | 3½              |
| Great Eastern.....          | 2½              | 2½              | 2½              | 2½              |
| Great Western.....          | 6½              | 6               | 5½              | 5½              |
| Great Northern.....         | 3               | 2½              | 2½              | 2½              |
| London & North Western..... | 7               | 6               | 6               | 5               |
| London & South Western..... | 5½              | 5½              | 5½              | 7               |
| Midland.....                | 4½              | 4               | 4               | 4               |
| North Eastern.....          | 7               | 6½              | 6½              | 6½              |
| South Eastern.....          | 4               | 3½              | 3½              | 3½              |
| Average.....                | 4.82            | 4.48            | 4.40            | 4.58            |

(From War's Effect on British Securities, James H. Oliphant & Co., New York, p. 25.)

In the United States, however, we find the guaranteed net income, after the payment of all interest charges, will very much more than insure the payment of dividends and a large surplus for all the principal railroads of the nation.

The guaranteed return for the railroads in the United States, not *in toto*, but *in proportion to the capitalization outstanding*, is approximately \$250,000,000 greater than the return guaranteed to British railroads.

#### NO INCENTIVE FOR EFFICIENCY

The gravest objection to the proposed legislation now pending in Congress is that it leaves practically no incentive for efficient operation. During this transition period we will have neither

<sup>4</sup> November 21, 1914, p. 683.

<sup>5</sup> February 26, 1916, p. 398.

<sup>6</sup> See below, sec. V, B, 2.

complete private control nor government control in actual practice. The government has the right of unlimited interference in operation, the companies retain the title to the properties, and their employes retain actual physical control of the operation of the plant. During this transition period it would be well if there were some strong incentive for efficient operation. Of course the spirit of patriotism and the desire to do one's duty in times of either peace or war prompt the activities of practically all of us. And yet, it needs but a moment's reflection to recall a very substantial difference in the attitude of the employes for a company at competitive points and at non-competitive points. The stimulus of greater financial reward needs no argument to support it; everybody recognizes it in practically every branch of human industry—except possibly in the ministry and even there the same human stimulus is used constantly. The magic wand of government operation may transform railroad stocks into government bonds, but it will not change railroad managers and engineers into angels; they are still human beings.

The government will present this guaranteed return to the railway companies without any regard to the work that they may perform in the future. They get their 8 per cent or 50 per cent on their stock whether the service they render is poor, good or excellent. And the temptation to discredit government operation will be a powerful factor, although it may be followed unconsciously only.

A suggested compromise might be made that the companies shall be guaranteed their usual interest and dividends, but that they shall have no surplus, except as they may earn it. This surplus should not be capitalized; but the value of improvements to the property in order to sustain the full value of outstanding securities is inestimable and is recognized by all practical railroad men.

#### CAPITALIZING SURPLUS

The measure now pending before Congress proposes to capitalize the surplus earnings of railway companies. The authors of this measure are asking Congress to reverse a principle which has been adopted unanimously by the Interstate Commerce Commission, in a decision written by Mr. Secretary Franklin K. Lane, while he was a member of that tribunal. They are asking Congress to adopt into law a doctrine which Mr. Lane branded as unjust.

The authors of this measure are asking Congress to adopt into law a doctrine which two of the leading railroad presidents in the nation have stated on the witness stand would be unfair to the public.

The railroad industry is peculiar among the enterprises of the country. By state statutes, acts of Congress and city ordinances we are constantly requiring railroads to build improvements which bring little or no additional revenue, such as elevated tracks, more ornamental depots, etc. They have asked us to help build these things which we require, by allowing them a large surplus over and above reasonable dividends, on condition that they will not capitalize these surplus earnings.

Mr. Ripley, the president of the Santa Fé, testified under oath on the witness stand before the Interstate Commerce Commission in 1910 as follows:

MR. LYON: But, take the condition of a road, we are assuming as the case where you have a dividend of \$10,000,000 and you collect from the public an additional \$10,000,000, and that pays for all necessary improvements demanded by that particular line of railway.

MR. RIPLEY: Well, it might.

MR. LYON: I said assume that it would.

MR. RIPLEY: Yes.

MR. LYON: Then in the future in determining the rate you would not consider the value of that property acquired through the \$10,000,000 taken from the public previously for that purpose?

MR. RIPLEY: No.

Again referring to this money put into the property out of earnings Mr. Lyon asked:

It is their money and they have invested it, and you would not expect any return upon it?

To this Mr. Ripley again replied that he would not.<sup>7</sup>

Mr. Willard, president of the Baltimore and Ohio, and chairman of the committee representing the eastern railroads, testified under oath on the witness stand before the Interstate Commerce Commission in 1910 as follows:

COMMISSIONER LANE: None of your surplus should be capitalized, as I understand you to say?

MR. WILLARD: None of the surplus that has been spent so far on the Baltimore and Ohio has been capitalized and in my opinion it should not be; and when the surplus that I speak of—the 50 cents for each dollar that I speak of **which**

should be put in the property in each year—is spent, it should not in my opinion be capitalized. My thought is that at least that much money should be spent on the property each year to afford a proper basis of support for the existing securities.

The Interstate Commerce Commission in their unanimous decision in the Advanced Rate Cases of 1911, stated, in the language of Mr. Secretary Franklin K. Lane, the following:

There is no justification for the investment of surplus, if it is to have the effect of increasing the rates upon the shipper over the original lines. If the theory is to be recognized that by increasing the value of their property, by putting back operating revenues into the property a carrier may as a legal right increase rates, then the shipper is worse off each time he pays a rate which yields a revenue over and above a reasonable return upon the original investment.<sup>7</sup>

This measure now pending, and which may become law, repudiates the doctrine which has been formally adopted by the Commission, with the approval of the leading railroad witnesses, in a case where that very proposition was squarely at issue, and in a case in which practically all the railroads of the country were parties. The authors of this measure desire to make the shipper pay freight rates adequate to prevent any deficit under government operation, and they desire to guarantee a return on all improvements whether built out of new money or out of earnings, whatever the source may be. If that principle is adopted by Congress it will cost the consumers and producers of this nation almost \$200,000,000 annually; and it will be in defiance of what the Commission and the railroad officials themselves have said is just.<sup>8</sup>

### CONCLUSION

The railway companies retain title to their properties, and retain the actual control in practical operation. We protect the

<sup>7</sup> Senate Document, 61st Congress, pp. 79–80.

<sup>8</sup> *Western Advanced Rate Case*, 20 I. C. C. 307, 342.

<sup>9</sup> In partial recognition of the principles discussed in this article it is now quite probable that Congress will pass two amendments to the measure as originally proposed: (1) leaving final jurisdiction over rates with the Interstate Commerce Commission, and (2) providing that the compensation shall not be increased in order to pay a return on improvements built out of surplus during the period of government operation. However, unless further amendments are adopted, the Commission will lose its power of suspending rates pending investigation, the improvements built out of surplus during former years will be capitalized, and the enormous earnings described in the text will be guaranteed by our government to this favored industry.

carriers from the effect on their revenues resulting from the diversion of traffic; but we also shield them from other hazards. If labor becomes scarce, or wages exorbitant, it will not have any effect whatever on the carriers' revenues. If they need more money to put into the plant, we guarantee to furnish it. If repairs cannot be made, we furnish the money to do it later.

If the carrier needs more high-priced materials, we furnish them, and at the same time preserve their net earnings, sacred and untouched, on that high plane they reached in the most prosperous three-year period they ever saw. Other industries do not get this protection. But the railroads are rich and powerful. They own so much property everywhere and control so many newspapers and magazines.

Other industries may feel the blighting effect of the war, and suffer—the railroads will be shielded from all that. With the mighty arm of the great government we select the railroad stockholder from out of the masses of the people. We select this two-thirds of 1 per cent of our population and tell them that they shall go through this terrible ordeal of war absolutely harmless. Others may perish, but these rich powerful railroads shall continue to revel in the greatest prosperity they ever witnessed in all their history.

By the fiat of government we will suddenly transform seventeen thousand million dollars of railroad stocks and bonds into government bonds. Not only that, but we will capitalize all their surplus earnings, although the Supreme Court and the Interstate Commerce Commission, the two highest tribunals in the land, have refused to sanction such a doctrine. We are asked to capitalize the surplus of these railroads although Mr. Ripley of the Santa Fé, and Mr. Willard of the Baltimore and Ohio, on the witness stand under oath, stated that they should not be capitalized.

Brave, true, noble patriots—willing to sacrifice their time and their property, providing of course that they get more for it than ever before. What an inspiring spectacle to give the rest of the country! And what a noble, happy thought it was to select the railroads at this time of trial and sacrifice to inspire us with patriotism. The cold chill that will go out among our people when these facts are really known will be something alarming. Such short-sighted policies as these will but hasten the day of reckoning for American railroads.

In dealing with these questions of large moment, we must have a care for we are adopting principles that will control the operation of the second greatest industry in the nation during the most critical time in our history, except only for the period of the Civil War. And these conclusions that we reach will have a profound effect on any subsequent purchase or regulation of these vast properties. This is not a time for the abandonment of those principles which we have found to be wise and just. In venturing out into the new and the unknown it is well to cling close to the wisdom acquired by the slow process of the experience of the past. In that way, and that way alone, can true progress be accomplished and justice be rendered to all parties.